

**DEPARTMENT OF STATE REVENUE
LETTER OF FINDINGS NUMBER 99-0475
INDIANA GROSS INCOME TAX / WITHHOLDING LIABILITY
For Years 1996, 1997, and 1998**

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ISSUES

I. Withholding Gross Income Tax for Nonresident Contractors : Interstate Commerce Exemption.

Authority: IC 6-2.1-3-3; IC 6-2.1-6-1(a); IC 6-2.1-6-1(b); IC 6-8.1-5-1(b); Indiana Dept. of State Revenue v. Brown Boveri Corp., 439 N.E.2d 561 (Ind. 1982); Reynolds Metals Co. v. Indiana Dept. of State Revenue, 433 N.E.2d 1, 8 (Ind. Ct. App. 1982); 45 IAC 1-1-49; 45 IAC 1-1-49(1); 45 IAC 1-1-84; 45 IAC 1-1-213; 45 IAC 1.1-1-24(b)(1).

Taxpayer protests the assessment of withholding tax liability for twelve nonresident contractors who performed work at taxpayer's Indiana engine manufacturing facility.

II. Request for Abatement of the Negligence Penalty.

Taxpayer has requested that the ten-percent negligence penalty, assessed for its failure to comply with the taxpayer's obligation to withhold the state gross income tax, be abated.

Authority: IC 6-8.1-10-2.1(d); IC 6-8.1-10-2.1; 45 IAC 15-11-2(b); 45 IAC 15-11-2(c).

Statement of Facts

The taxpayer is a multinational publicly held corporation with headquarters located outside Indiana. The taxpayer has divided its operation into two major business segments. The first business segment is involved in the design, manufacture, and marketing of construction, excavation, and transportation machinery. The first segment's activities include sales directed into Indiana and sales made directly from the taxpayer's Indiana warehouse facility. The second business segment is involved in the design, manufacture, and marketing of engines for earthmoving, construction, agricultural, electrical

generation, railroad, marine, and other applications. One of taxpayer's two Indiana locations is part of the second business segment. Although that location manufactures various large engines on an assembly line basis, the engines are not manufactured until the customer has determined the exact specifications for an individual engine and has placed an order for that engine.

I. **Withholding Gross Income Tax for Nonresident Contractors** : Interstate Commerce Exemption.

DISCUSSION

The taxpayer protests the assessment of withholding tax liability for various nonresident contractors who performed work and provided services at taxpayer's Indiana large engine facility.

Taxpayer asserts it was not required to withhold gross income tax on behalf of twelve contractors who performed work at the taxpayer's Indiana large engine facility. The taxpayer cites 45 IAC 1-1-213 which states in relevant part that, "Indiana gross income tax is required to be withheld from any and all payments made to a nonresident contractor for performance of any work or services *which are taxable to the State of Indiana.*" (Emphasis added). The taxpayer asserts that the transactions were not subject to Indiana tax quoting Indiana Dept. of State Revenue v. Brown Boveri Corp., 439 N.E.2d 561 (Ind. 1982) for the proposition that where the local activities of a foreign corporation, including installing, testing, and adjusting, are intrinsically related to and inherently part of a sale in interstate commerce, the transaction is seen as one continuing transaction, protected as interstate commerce, and exempt from the state gross income tax. In summary, taxpayer argues that the proposed assessment is clearly in violation of the U.S. Const. art. I, § 8.

The audit determined that the twelve contractors, performing work at taxpayer's Indiana location, had established an actual situs in Indiana during the time the work was performed as defined within 45 IAC 1-1-49. Because the contractors performed services within Indiana, they were brought into the grip of taxation for Gross Income. Additionally, the twelve nonresident contractors had not filed Indiana income tax returns and were not registered with the Indiana Secretary of State to conduct business within Indiana. Therefore, after granting each nonresident contractor the statutory \$1000 exemption, the audit assessed tax due on the entire amount of the invoice computed at the rate of 1.2 percent.

In order to prevail in its protest, the taxpayer is required to carry its burden of proof by demonstrating that the proposed tax has been incorrectly assessed. IC 6-8.1-5-1(b) states in relevant part that "[t]he notice of proposed assessment is prima facie evidence that the department's claim for the unpaid tax is valid. The burden of proving that the proposed assessment is wrong rests with the person against whom the proposed assessment is made." Further, because the taxpayer asserts that the transactions at issue are not subject

to the Gross Income Tax by virtue of the protection afforded under the Interstate Commerce Clause, as “[t]he party claiming an interstate commerce exemption, or . . . the danger that he is subject to the risk of multiple taxation, bears the burden of establishing such facts, and any doubt should be resolved in favor of the tax.” Reynolds Metals Co. v. Indiana Dept. of State Revenue, 433 N.E.2d 1, 8 (Ind. Ct. App. 1982).

45 IAC 1-1-84 authorizes the imposition of Indiana’s Gross Income Tax on income generated by nonresidents. “The gross income tax is levied upon the total gross receipts of nonresident taxpayers which are derived from activities or businesses in the state or other Indiana sources.” Therefore, “the tax on nonresidents is limited basically to receipts from activities connected with a business situs.” 45 IAC 1-1-84. The manner in which a nonresident contractor establishes a business situs is defined in 45 IAC 1-1-49 which states that “a taxpayer may establish a ‘business situs’ in ways including but not limited to . . . [the] [p]erformance of services.” 45 IAC 1-1-49(1).

An exception is provided for specific nonresidents under the provisions of IC 6-2.1-6-1(a), which exempts nonresident contractors which are “qualified to do business in

Once a foreign entity is determined to be a “nonresident contractor,” and to have established a business situs within the state of Indiana, 45 IAC 1-1-213 imposes upon the entity making the contract payment a duty to withhold gross income tax. “Indiana gross income tax is required to be withheld from any and all payments made to a nonresident contractor for performance of any work or services which are taxable to the state of Indiana.” 45 IAC 1-1-213. Even though the burden of paying the tax remains with the out-of-state contractor, the local entity has the burden of withholding that tax.

Therefore, the taxpayer, as the Indiana entity, was required to withhold the gross income tax on payments made to its out-of-state contractors. By performing work within the state of Indiana, the out-of-state contractors established a business situs within Indiana. Because the out-of-state contractors were not registered with the Indiana Secretary of State of state, the contractors were not “qualified to do business in Indiana” as defined within IC 6-2.1-6-1(a).

However, the taxpayer invokes the Interstate Commerce Clause as providing a blanket exemption on behalf of the twelve out-of-state contractors. IC 6-2.1-3-3 exempts from the Indiana tax “[g]ross income derived from business conducted in commerce between the state of Indiana and either another state or a foreign country . . . to the extent the state of Indiana is prohibited from taxing that gross income by the United States Constitution.” The application of IC 6-2.1-3-3, and specifically the Interstate Commerce exemption (U.S. Const. art. I, § 8), has been set out in Indiana Dept. of State Revenue v. Brown Boveri Corp., 439 N.E.2d 561 (Ind. 1982). Boveri stands for the proposition that when the local activities of an out-of-state company are intrinsically and inherently related to a transaction taking place in interstate commerce, the entire transaction is shielded by the Interstate Commerce Clause and, necessarily, exempt from the state gross income tax. Id. at 564.

For eleven of the twelve contractors at issue, the taxpayer has failed to meet its burden of demonstrating that the contractors' local activities were so intrinsically related to the interstate transaction as to be exempt from the Indiana's Gross Income Tax and the taxpayer's consequent obligation to withhold that tax under 45 IAC 1-1-213. Statutorily, taxpayer, has the "burden of showing that the proposed assessment is wrong." IC 6-8.1-5-1(b). Specifically, a claim of exemption under the Interstate Commerce Clause requires that the taxpayer "bear[] the burden of establishing such facts, and any doubt should be Reynolds, 433 N.E.2d at 8. Because taxpayer has failed to meet its burden of proof, taxpayer's protest, so far as it relates to the eleven contractors located in other states, is denied.

As to the transaction with the remaining twelfth contractor, the taxpayer has supplied information that suggests the transaction may indeed be analogous to the facts set forth in Indiana Dept. of State Revenue v. Brown Boveri Corp., 439 N.E.2d 561 (Ind. 1982). However, intriguing as the taxpayer's argument may be, it is essentially not the taxpayer's argument to make. The taxpayer is setting forth a defense to the imposition of gross income tax which may be made by a nonresident contractor but not by taxpayer because the taxpayer's duty to withhold does not turn on whether the transaction is or is not subject to the gross income tax. Under IC 6-2.1-6-1(b), "each individual, firm, organization, or governmental agency *of any kind* who makes payments to a nonresident contractor for performance of any contract, except contracts of sale, *shall withhold* from such payments the amount of gross income tax owed upon the receipt of those payments." (Emphasis added). Under 45 IAC 1.1-1-24(b), the taxpayer is a "withholding agent" for the state of Indiana because that "term includes a person or entity making payments to a non-resident contractor." As a designated withholding agent, the taxpayer was obligated to withhold taxes from the performance of a "[a] construction contract of any kind." 45 IAC 1.1-1-24(b)(1).

Therefore, because the taxpayer lacks the standing to set forth the aforementioned defense to the imposition or withholding of gross income taxes, the taxpayer's protest must be denied in total.

FINDING

Taxpayer's protest is respectfully denied.

II. Request for Abatement of the Negligence Penalty.

DISCUSSION

The taxpayer has protested the imposition of the ten-percent negligence penalty assessed under authority of IC 6-8.1-10-2.1. Departmental Regulation 45 IAC 15-11-2(b) defines negligence as "the failure to use such reasonable care, caution, or diligence as would be

expected of an ordinary, reasonable taxpayer.” IC 6-8.1-10-2.1(d) allows the negligence penalty to be waived upon a showing that the failure to pay the delinquency was due to “reasonable cause.” In order to establish “reasonable cause,” 45 IAC 15-11-2(c) requires that the taxpayer demonstrate that it “exercised ordinary business care and prudence in carrying out a duty or failing to carry out a duty giving rise to the penalty imposed.”

The taxpayer has failed to demonstrate that it exercised reasonable care in meeting its obligation to withhold taxes. The taxpayer is a large, sophisticated, business entity fully capable of either determining its tax obligations independently or in consultation with the Department concerning those obligations of which it is uncertain. There is no evidence that the taxpayer investigated to determine whether the individual contractors were registered to do business in Indiana. In addition, the identical issues raised in the instant protest have been raised by the identical taxpayer before the Department in the past. Taxpayer cannot complain that it was unaware of its obligations to withhold Gross Income Tax for out-of-state contractors or the parameters used to determine the applicability of the Interstate Commerce Clause exemption.

FINDING

Taxpayer’s protest is respectfully denied.